THE FINANCIAL SERVICES ROUNDTABLE 

Testimony of

The Financial Services Roundtable

Submitted for the Record

For the

United States House of Representatives
Financial Services Subcommittee on
Financial Institutions and Consumer Credit

Hearing

on

H.R. 3951
The "Financial Services Regulatory Relief Act of 2002"

April 25, 2002

I. Introduction

The Financial Services Roundtable appreciates the opportunity to submit testimony on H.R. 3951, the "Financial Services Regulatory Relief Act of 2002." The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO.

Roundtable member companies provide fuel for America's economic engine, accounting directly for $12.4 trillion in managed assets, $561 billion in revenue, and 1.8 million jobs.

II. H.R. 3951, the "Financial Services Regulatory Relief Act of 2002"

The Roundtable strongly supports H.R. 3951. We believe it is important for Congress to periodically review the laws applicable to the financial services industry and to revise those laws when they become outdated or impose unwarranted costs on consumers. Such adjustments to our laws also establish clearer guidelines for firms engaged in financial services activities.

The Roundtable wishes to express special thanks to Congresswoman Shelly Moore Capito (R-WV) for her introduction of this bill, and to Chairmen Mike Oxley (R-OH) and Spencer Bachus (R-AL) for their efforts to generate momentum for enactment of regulatory burden relief legislation this year.

While the Roundtable supports the bill as a whole, there are several provisions that deserve special comment.

A. Elimination of Barriers to *De Novo* Interstate Branching

The Roundtable strongly supports section 401 of the bill, which would remove certain existing restrictions on interstate branching and mergers. We believe that section 401 is a natural extension of the Riegle-Neal Interstate Banking and Branching Efficiency

Act of 1994, which expanded the interstate branching authority of banks. The passage of time has demonstrated that the benefits that were expected from that Act have in fact developed. The creation of new branches has helped to maintain the competitiveness and dynamism of the American financial services industry and has improved access to financial services in otherwise under-served markets. Branch entry into new markets has enhanced competition in many markets, and this, in turn, has resulted in a better array of financial services for households and small businesses and more competitive pricing of products. Furthermore, interstate branching has enabled banks to continue to serve the needs of consumers as they move, live, and work across state borders.

Currently, however, banks may not establish new offices (so-called "*de novo* branches") outside their home state unless the host state specially authorizes *de novo* branching. Only 17 states have enacted legislation to allow *de novo* entry. Both large and small financial institutions have found this limitation on *de novo* branching to be costly and burdensome and, in some cases, an absolute barrier to entry.

H.R. 3951 would permit *de novo* interstate branching for state and national banks without an affirmative opt-in from the host state. As the Office of the Comptroller of the Currency ("OCC") and the Federal Reserve Board ("Board") have testified, this change will bring benefits to financial institutions and their customers by permitting an institution to select which form of interstate expansion is best suited for its market. It also will provide to all financial institutions and their customers the benefits that thrifts and their customers have long experienced.

B. Reduction of Cross-Marketing Restrictions

The Roundtable strongly supports section 501 of the bill, which would make two modifications to the cross-marketing restrictions imposed by the Gramm-Leach-Bliley Act of 1999 ("GLBA"). First, section 501 would permit depository institutions controlled by a financial holding company to engage in cross-marketing activities with companies in which a merchant banking affiliate has made an investment to the same extent, and subject to the same restrictions, as companies in which an insurance affiliate has made an investment. Presently, an insurance affiliate of a financial holding company may engage in cross-

marketing with a company in which the insurance affiliate has made an investment if (1) the cross-marketing takes place only through statement inserts and Internet websites, (2) the cross-marketing activity is conducted in accordance with the anti-tying restrictions of the Bank Holding Company Act ("BHCA"), and (3) the Board determines that the proposed arrangement is in the public interest, does not undermine the separation of banking and commerce, and is consistent with the safety and soundness of depository institutions. Under current law, however, a merchant banking affiliate of a financial holding company may not engage in such limited cross-marketing activities with the companies in which it makes investments. Section 501 would establish parity of treatment between financial holding companies that own insurance affiliates and those that own merchant banking affiliates. The Roundtable agrees with the Board that such parity of treatment is appropriate and is not a violation of the separation of banking and commerce.

Second, section 501 would permit a depository institution subsidiary of a financial holding company to engage in cross-marketing activities with a nonfinancial company held by a merchant banking affiliate if the nonfinancial company is not controlled by the financial holding company. We agree with the bill's premise that, when a financial holding company does not control a portfolio company, cross-marketing activities are unlikely to materially undermine the separation between banking and commerce. As the Board has testified, in these non-control situations, the separation of banking and commerce is maintained by the other restrictions contained in GLBA that limit the holding period of the investment and restrictions that limit the financial holding company's ability to manage and operate the portfolio company.

C. Parity for Banks and Thrifts Under Federal Securities Laws

The Roundtable strongly supports section 201 of the bill, which would extend to thrifts the exemptions that banks have from investment adviser and broker-dealer registration requirements. Under current law, banks are exempt from registration under the Investment Advisors Act of 1940, and have, in the past, enjoyed a blanket exemption from broker-dealer registration requirements under the Securities Exchange Act of 1934. Thrifts have had neither exemption. While the Securities and Exchange Commission ("SEC") has

the authority to correct this disparity, and has taken some regulatory steps to do so, there is no certainty that it will do so.

The Office of Thrift Supervision ("OTS") and the SEC have recognized that this differential treatment is no longer logical. The trust powers of banks and thrifts are essentially the same. Additionally, banks and thrifts provide investment advice, trust and custody, third party brokerage, and other related services in relatively the same manner.

D. Removal of Post-Approval Waiting Period

The Roundtable strongly supports section 609 of the bill, which would permit the consummation of a merger transaction immediately upon approval of the merger by the appropriate federal financial services agency. Under current law, there is a 30-day waiting period between the approval of a merger by a federal financial regulator and the consummation of the merger. If the appropriate federal financial regulator and the Attorney General agree, this waiting period can be shortened, but only to 15 days. Section 609, which is supported by the Federal Reserve and the OCC, would permit the waiting period to be eliminated if the agency and the Attorney General agree. This would eliminate the costly and often unnecessary delay imposed under current law.

E. Other Provisions in H.R. 3951

The Roundtable believes that several other provisions of the bill are noteworthy. These provisions include section 103, which would simplify dividend calculations for national banks; section 202, which would provide authority for thrifts to make investments for public welfare similar to those which banks are now permitted to make; section 403, which would eliminate certain reports from insiders that the Board has found do not contribute significantly to the effective monitoring of insider lending or the prevention of insider abuse; section 502, which would provide discretion to the Board to make exceptions under the rule that attributes to a bank holding company ownership of shares held in trust by that company; and section 601, which would permit the federal banking agencies to adjust examination schedules in order to more efficiently allocate resources among the institutions most in need of examination.

III. Additional Recommendations

As H.R. 3951 moves through the Financial Services Committee, the Roundtable recommends that the bill be expanded to address some other existing laws that impose unnecessary burdens on financial services firms and their customers.

A. Investment Authority for State Member Banks

An early draft of H.R. 3951 would have given the Federal Reserve Board the authority to allow state member banks to engage in investment activities authorized by their chartering state and the Federal Deposit Insurance Corporation ("FDIC"). The Roundtable believes that the Board should have this authority. Under current law, state member banks are limited to activities permitted for national banks. State nonmember banks, however, may engage in a potentially wider range of activities, including those not authorized for national banks, if the FDIC finds that such activities present no risk to the deposit insurance fund. There is no reason to discriminate between state-chartered banks, simply because of their membership in the Federal Reserve System. An empowered state banking system is essential to the evolution of the financial services industry and the preservation of the dual banking system. The addition of this provision would help advance those goals. We encourage the Committee to reincorporate it in the bill.

B. Removal of Price Variance Part of Anti-Tying Rules

The Roundtable encourages the Committee to repeal the price variance feature of the existing anti-tying rule so a financial institution can give a price break to a customer if that customer decides to purchase other products and services from the institution. Financial institutions should have the ability to offer a customer a price break on a product or service if the customer decides to buy another product or service. This change would not encourage anti-trust activities. Unlike the classic tying case, the customer could not be forced into buying a product. If the customer thinks the price break is good enough, he or she can buy the product. If the customer does not think the price break is good enough, he or she is under no obligation to buy the product. We encourage the Committee to adopt this consumer friendly amendment.

C. Consumer Loans by Thrifts

The Home Owners' Loan Act ("HOLA") limits the amount of loans a federal thrift can make for "personal, family and household purposes." Currently, a federal thrift cannot commit more than 35 percent of its assets to loans that will be used for personal, family, and household purposes. At the same time, HOLA places no limit on the amount of credit card and educational loans by a federal thrift. We believe all consumer loans, regardless of their purpose, should be treated like credit card loans and educational loans. There is an obvious consumer advantage in expanding the competitive market for consumer lending. HOLA should be modified to reflect this goal. Therefore, we ask the Committee to amend the bill to remove the limitations on loans for personal, family or household purposes.

D. Diversity Jurisdiction for Federal Thrifts

Under current law, a federal thrift that has interstate operations is not deemed to be a citizen of any state, and, therefore, cannot bring a legal action in federal court based upon diversity jurisdiction. We ask the Committee to address this anomaly in the law. A federal thrift that is not engaged in interstate operations is deemed to be a citizen of the state in which it is located and can bring a suit in federal court based on diversity of citizenship. Furthermore, a national bank, whether engaged in local or interstate activities, is deemed to be a citizen of the state in which it is chartered and may bring an action in federal court based upon diversity. Federal thrifts with interstate operations should have the same recourse to federal courts as thrifts without interstate operations and national banks.

E. QTL Test for Multi-State Thrifts

Under current law, a thrift with operations in multiple states must meet the qualified thrift lender ("QTL") test not only on a multi-state basis, but also in every state in which it has branches. The net result of this rule is to restrict the free flow of commerce between and among the states, and to misallocate resources to meet the arbitrary demands of the statute. With the barriers to interstate operations rapidly falling away, continuation of the individual state test for multi-state thrifts is anachronistic. Permitting multi-state thrifts to

meet the QTL test on a multi-state basis would be a good example of regulatory relief that would encourage the free flow of goods across state borders.

F. National Deposit Ceiling

Under current law, a depository institution may hold no more than 10 percent of all deposits in the country. This 10 percent deposit ceiling is based upon the total number of deposits held by all commercial banks and thrifts. With the successful growth of credit unions and the expansion of foreign bank branches in the U.S., the deposit options for consumers extend beyond just commercial banks and thrifts. Therefore, we ask the Committee to adjust the base for purposes of calculating the 10 percent ceiling to include deposits held by credit unions and U.S. branches of foreign banks. We are not recommending any change in the percentage limitation, only that the base be revised. This provision was included in an earlier version of the bill, and we ask that it be reincorporated.

G. Treatment of CDs Issued by Federal Thrifts

Currently, FDIC-insured certificates of deposit ("CDs") issued by federal thrifts and national banks are not classified as securities under federal securities and banking laws. As such, CDs issued by federal thrifts and national banks do not need to be registered with the SEC. Many states, however, treat CDs as securities. While all of the states that do so have exempted banks and federal thrifts from applicable registration requirements, some have required registration of exclusive agents of federal thrifts. This requires the federal thrift to pay a registration fee to the state and requires the agents to pass one or more NASD examinations. We ask the Committee to preempt states from requiring persons who represent a federal thrift in selling deposit products to register as a state securities law agent.

H. Treatment of Thrift Agents

Another recommended amendment that is similar to the previous one relates to the treatment of mortgage loan agents of federal thrifts. Currently, federal thrifts and their employees are exempt from state mortgage broker or mortgage lender licensing statutes. On the other hand, exclusive agents of federal thrifts are not exempt from these state

statutes. We ask the Committee to amend HOLA to exempt exclusive agents from these state laws.

I. CRA for CEBA Banks

We recommend that the Committee permit banks subject to the terms of the Competitive Equality Banking Acting (so-called "CEBA" banks) to meet their Community Reinvestment Act ("CRA") obligations through community development lending as well as other forms of lending. CEBA banks, by their nature, often offer only a limited line of products. In many communities, there simply are not sufficient customers available for a CEBA bank to meet its CRA obligation unless the bank can count community development lending.

J. Usury Limit on Finance Companies

Federal law allows state-chartered banks to charge the same rates as nationally chartered banks, therefore eliminating the interest rate disparity between state and national banks in states such as Arkansas. Unfortunately, finance companies are treated as state-chartered banks for purposes of this law and, therefore, they continue to be subject to the usury rate cap in Arkansas. In today's rate environment, this means that finance companies are limited to five percent over the federal discount rate (which is around two percent) while banks can charge almost any rate necessary to secure a loan. The Roundtable recommends that the Committee amend the bill to eliminate this inequity and allow more competition.

K. Treatment of Collateralized Deposits In Bankruptcy

The Roundtable recommends that the Committee modernize the system by which banks collateralize deposits of bankrupt companies. Currently, banks may be required to pledge collateral to the United States government if they hold deposits of companies that are in bankruptcy. Yet, only surety bonds or U.S. government debt, which is unconditionally guaranteed by the U.S. government, are acceptable collateral for this requirement. Because of the decline in outstanding public debt and advances in capital markets, there are other obligations that should be considered by the U.S. Treasury as acceptable collateral.

Similarly, the value of collateral has been limited to par value, rather than market value. We ask the Committee to update the law governing the form and value of collateral to reflect current market practices and standards.

L. Regulation of Broker-Dealer Activities of Banks

GLBA gave the SEC the authority to regulate the broker-dealer activities of banks. Consistent with the Committee's desire to foster cooperation between the regulators of financial services firms, the Roundtable urges the Committee to amend GLBA to direct the SEC to consult with the federal banking agencies prior to the issuance of any regulations governing the broker-dealer activities of banks. This requirement would not limit the SEC's power over bank broker-dealers, but it would ensure that the SEC fully consider the views of the primary regulators of banks prior to the adoption of any regulation.

M. Interstate Trust Operations

Just as Congress has fostered the development of interstate branching and banking through the passage of the Riegle-Neal Act, the Roundtable urges the Committee to amend the bill to facilitate interstate trust activities. Today, the trust activities of financial institutions remain subject to a variety of state laws. These laws have inhibited the ability of institutions to provide trust services. Consumers today are more mobile than ever. A change to "interstate" trust laws to facilitate the providing of trust services to a greater number of people is long overdue.

N. Uniform Privacy Standard

With the enactment of GLBA, Congress acknowledged the need to protect the privacy of the individuals who seek or use financial services. Unfortunately, since GLBA was passed, we have seen a proliferation of proposed privacy laws by state and local governments that, if enacted, would create a patchwork of privacy requirements around the country. Such a balkanization of privacy laws would not only impose significant compliance costs on financial institutions, but would inevitably lead to customer confusion. Accordingly, we urge the Committee to adopt a uniform, national standard on financial privacy.

In the alternative, we urge the Committee to consider H.R. 3068, the "Financial Privacy and National Security Enhancement Act," sponsored by Congressman Bob Ney (R-OH). This legislation would set a four-year temporary "time-out" from the unintended harmful effects that state privacy laws could have on consumers, law enforcement, financial firms, and the U.S. economy. In addition, it would create a four-year Presidential Privacy Study Commission to assess the privacy protections provided by financial firms and to report on ways to improve consumer financial privacy, while preserving both the ability of institutions to service their customers and the effective information flow for national security purposes.

O. Anti-Fraud Network

Finally, the Roundtable recommends that the Committee incorporate H.R. 1408, "the Financial Services Anti-Fraud Network Act of 2001," into this bill. With our system of functional financial regulation, it is imperative that all financial regulators, state and federal, cooperate. H.R. 1408 fosters such cooperation by providing for the development of an anti-fraud network. The bill already has passed the House by a vote of 392 to 4, and, we believe, it would be an excellent addition to this measure.

IV. Conclusion

In conclusion, the Roundtable appreciates the opportunity to submit testimony on this important bill, and expresses its appreciation to all Members of the Committee, but particularly Chairman Bachus and Congresswoman Capito, for their effort on this legislation.